No. 21,185

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOAN E. HELLER TRUST, et al.,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

R spondent

ON PETITION FOR REVIEW OF THE DECISION OF THE

TAX COURT OF THE UNITED STATES

REPLY BRIEF FOR THE PETITIONERS

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ARGUMENT I.

The Government makes several contentions regarding the issue of taxpayers' liquidation of the duplexes resulting in ordinary income rather than capital gains.

The first argument is that this is a question of fact, and that the only issue on review is whether or not the decision of the Tax Court was "clearly erroneous". (B.15).

We agree that this issue involves a question of fact. We believe the rule is that this Court may reverse if the Tax Court's decision is "clearly erroneous", or if it is clear on the record as a whole, that a mistake has been made. Austin v. Commissioner, 263 F.2d 460 (C.A. 9).

We submit that the uncontradicted evidence set forth on pages 16 and 17 of our Opening Brief is more than sufficient to meet either of these review tests. Conversely, there are no decision or determinative facts to support the Tax Court's conclusion that from the beginning these dwelling units were held by the taxpayers for the primary purpose of sale. (R.100) There are only two alleged circumstances which would in any way support the Tax Court's findings: the FHA Application (Petitioners' Brief, Appendix 1), which is most inconclusive, and the fact that from 1948 to 1951 taxpayer Smotkin built houses for sale. Under the Government's argument, the taxpayer is apparently condemned forever to ordinary income treatment, because

four years prior to the sales in question he sold houses, even though the undisputed evidence was that taxpayers had no bought or sold one house (other than the duplexes in question) from 1951 to the present time. (Trans.30) The Government even reaches further. It claims that the fact that taxpayer Smotkin built and sold houses in Columbus, Ohio, in 1941, indicates that he must not have held the duplexes built in 1952 for rental or investment purposes. (B.17) This argument is made on the fact of evidence disclosing that taxpayer Smotkin shortly after 1941 left Ohio, and for several years was in the photo-finishing business in California. (R.91) We submit that where an investment and rental program has been followed through for a period of three years, "it is there for all to see", (Malat v. Riddell, 347 F.2d 23, 26 (C.A. 9), and in the absence of convincing evidence to the contrary, the Tax Court's opposite conclusion was "clearly erroneous" and must leave this Court with clear impression that a mistake has

four years prior to the sales in question he sold houses, even though the undisputed evidence was that taxpayers had no bought or sold one house (other than the duplexes in question) from 1951 to the present time. (Trans.30) The Government even reaches further. It claims that the fact that taxpayer Smotkin built and sold houses in Columbus, Ohio, in 1941, indicates that he must not have held the duplexes built in 1952 for rental or investment purposes. (B.17) This argument is made on the fact of evidence disclosing that taxpayer Smotkin shortly after 1941 left Ohio, and for several years was in the photo-finishing business in California. (R.91) We submit that where an investment and rental program has been followed through for a period of three years, "it is there for all to see", (Malat v. Riddell, 347 F.2d 23, 26 (C.A. 9), and in the absence of convincing evidence to the contrary, the Tax Court's opposite conclusion was "clearly erroneous" and must leave this Court with clear impression that a mistake has

been made. If taxpayer was holding these duplexes primarily for sale during the three-year rental period, he will surely go down in history as the world's worst salesman. He was not able, in this three-year period, to sell one of 194 duplexes!

If taxpayer, from the beginning, primarily intended to sell, rather than rent, he must have been very confused in his thinking, for there would have been no need for him to go to the expense and trouble of creating and operating six rental corporations and a management corporation. (R.88-d).

The Government contends that the purpose for which taxpayer is holding the property at the time of the sale is controlling. (B.12,20). This is not the law, and it is submitted that it could not be the law. If we just look at the time taxpayer is selling, then no one would be entitled to capital gain treatment, and the Statute would be nullified. Municipal Bond Corp. v. Commissioner, 341 F.2d 683, 689

(C.A. 8); Philber Equipment Corporation v. Commissioner, 237 F.2d 129 (C.A. 3). In the latter case, the Tax Court had held that even if there was no intention to sell at the time of original acquisition, the determining factor was the purpose for which the property was being held at the time of sale rather than the purpose for which it was originally acquired and held. The Third Circuit in reversing stated, (237 F.2d 129 at 132-133):

> "We cannot subscribe to this 'alternative ground'. To do so would make for judicial nullification of Section 117(j).
>
> The essence of the Tax Court's alternative ground is that property changes character merely by the fact of being exposed for sale. We agree with taxpayer that such a concept is neither logical nor reasonable."

In McGah v. Commissioner, 193 F.2d 662 (C.A. 9), this Court recognized that same rule. The Tax Court had held that houses were being held at the time of the sale, primarily for sale to customers in the ordinary course of a trade or business. This Court remanded for findings as to how the houses were held prior

to the time of sale.

The Tax Court in another post Malat decision attempted to use the reasoning of the Government and the Tax Court here. In William A. Scheuber v. Commissioner, 25 T.C.M. 599 at p.564 (1966 CCH - TCM 1966-107) the Court stated:

> "It is the principal or primary purpose at the time of the sale that is significant [citing cases]. Even if we were to conclude that the property in question was originally acquired by petitioners as an investment, that purpose is necessarily subject to change. The original purpose then is replaced by a subsequent one, if any, and we must determine the purpose of first importance at the time of sale. Bauschard v. Commissioner, supra; Mauldin v. Commissioner, 195 F.2d 714 (C.A. 10) (1952) affirming 16 T.C. 698 (1951)."

The Seventh Circuit just recently reversed this case and its findings as being clearly erroneous. Scheuber v. Commissioner, 370 F.2d , decided February 2, 1967 (1967-1 USTC 9219).

We note that the Government dismisses the latest Supreme Court case on the capital gains issue with a footnote (B.20). We further note that the Government fails to distinguish

or cite Municipal Bond Corp. v. Commissioner, 46 T.C. 219 (on remand from the Eighth Circuit 341 F.2d 683, and pursuant to Malat). The Government has failed to answer the arguments on Malat set forth in our Opening Brief (B.15-20). Respondent attempts to dismiss Malat by saying (B.20, FN 8):

> " * * * Here, of course, the Tax Court noted (I-R.101) taxpayer did have a rental purpose in mind when acquiring the property, but that the purpose of first importance was sale. As our brief shows, there is sufficient evidence to support this finding."

We submit that the Tax Court never made a finding that taxpayer at acquisition had in mind as of first importance, the sale of the property (Petitioner's Brief 19). We further submit that Respondent's brief does not show evidence to support any such finding.

ARGUMENT II.

For the reasons stated in our Opening Brief, we believe the contracts in question had no ascertainable fair market value.

CONCLUSION

The decisions of the Tax Court are erroneous and should be reversed.

Respectfully submitted,

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I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

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Attorney